

CHIEF INVESTMENT OFFICE

Fixed Income Spotlight

2026 Year Ahead Outlook: Actively Neutral

All data, projections and opinions are as of December 8, 2025 and subject to change.

SUMMARY

- We expect continued Federal Reserve (Fed) easing in 2026, although economic growth should remain strong, and advocate “actively neutral” positioning in Fixed Income.
- We prefer that investors move excess cash into risk assets and Fixed Income of a reasonable duration. Within Fixed Income, remain neutral across sectors and interest-rate risk, being patient until better valuation opportunities afford themselves.
- We maintain a neutral view on Investment-grade (IG) and High Yield (HY). While macro and fundamental conditions remain broadly supportive, spreads are near historically low levels, and we anticipate modest widening, driven by technical factors.
- Our neutral stance on Mortgage-backed Securities (MBS) also remains unchanged. Performance has been solid, and valuations appear close to fair value relative to other high-quality Fixed Income sectors such as IG corporates.

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ASSET CLASS WEIGHTINGS

Asset Class	Underweight	Neutral	Overweight
Fixed Income	●	●	●
U.S. Investment-grade Taxable	●	●	●
International	●	●	●
Global High Yield Taxable	●	●	●

These Chief Investment Office (CIO) views relate to fully-diversified, multi-asset class portfolio and use the asset class breakdown of the CIO “High Tax/Balanced” Allocation. Source: Global Wealth & Investment Management Investment Strategy Committee as of December 2, 2025.

FIXED INCOME U.S. RATES FORECAST

(% end of period)	SPOT	4Q25	1Q26	2Q26	3Q26	4Q26
Fed Funds Range	3.89	3.75–4.00	3.75–4.00	3.50–3.75	3.00–3.25	3.00–3.25
2-Year T-Note	3.54	3.50	3.45	3.35	3.25	3.25
5-Year T-Note	3.73	3.65	3.60	3.55	3.50	3.50
10-Year T-Note	4.16	4.00	4.05	4.15	4.20	4.25
30-Year T-Bond	4.8	4.60	4.65	4.65	4.70	4.75

Source: BofA Global Research U.S. Rates Research; December 12, 2025; spot price as of that date. Note: Federal funds rate forecasts are model expectations; other values are for market rates. The forecasts in the table above are the baseline view from BofA Global Research team. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts. **There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment outcomes.**

FIXED INCOME AT A GLANCE

Rates Markets	28-Nov	Last Month	Change
Fed Funds rate	3.88%	3.88%	+0 bps
3-month Treasury Bills	3.80%	3.82%	-1 bps
U.S. 2-year Note	3.49%	3.58%	-8 bps
U.S. 5-year Note	3.60%	3.69%	-9 bps
U.S. 10-year Note	4.02%	4.08%	-6 bps
U.S. 30-year Note	4.66%	4.65%	+1 bps
FF / 10s Curve	+14 bps	+20 bps	-6 bps
2s / 10s Curve	+52 bps	+50 bps	+2 bps
German 10-year	2.69%	2.63%	+6 bps
UK 10-year	4.44%	4.41%	+3 bps
Japanese 10-year	1.81%	1.66%	+14 bps

Credit Markets	28-Nov	Last Month	Change
U.S. Investment Grade (Spread)	+80 bps	+78 bps	+2 bps
U.S. High Yield (Spread)	+269 bps	+281 bps	-12 bps
U.S. High Yield (Yield)	6.57%	6.78%	-21 bps
Emerging Markets (U.S.\$, Spread)	+188 bps	+182 bps	+6 bps
10-year AAA Municipal	2.74%	2.73%	+0 bps
10-year Muni / Treasury Ratio	68.2%	67.0%	+1.2%

Index Returns	1-month	12 months	Year-to-Date
U.S. Treasury	0.6%	5.0%	6.7%
U.S. MBS	0.6%	6.6%	8.4%
U.S. ABS	0.6%	5.6%	5.6%
U.S. CMBS	0.8%	7.3%	7.5%
U.S. Corporate	0.7%	5.9%	8.0%
U.S. High Yield	0.6%	7.5%	8.0%
U.S. Leveraged Loans	0.3%	5.8%	5.2%
U.S. Municipal	0.2%	2.6%	4.2%
U.S. Municipal High Yield	0.4%	1.0%	2.7%

Bps refers to basis points. Source: Bloomberg. Data as of November 28, 2025 and subject to change. **Past performance is no guarantee of future results. Please refer to the end of the document for asset class proxies and index definitions.**

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Throughout 2025, we maintained a constructive view on the U.S. macroeconomy based on several key factors: continued high federal government spending, an executive branch eager to avoid a recession, a Fed in rate-cutting mode and more worried about maximum employment than inflation, and a strong corporate spending cycle that remains in early stages. The year began with the 10-year Treasury near 5%; we maintained a favorable duration bias whenever rates were in the mid-to-high 4%+ level.

Despite the tremendous volatility in April, our pro-risk and pro-Fixed Income stance served us well. The Fed did cut three times, bringing the fed funds rate down to 3.625%, and the 10-year is now right around 4%, substantially lower than it began the year. While the main drivers of economic strength remain, in our opinion, most of the yield curve is substantially lower and steeper than it was in early 2025, and credit spreads remain historically tight. Overall valuations, therefore, are in a very different place.

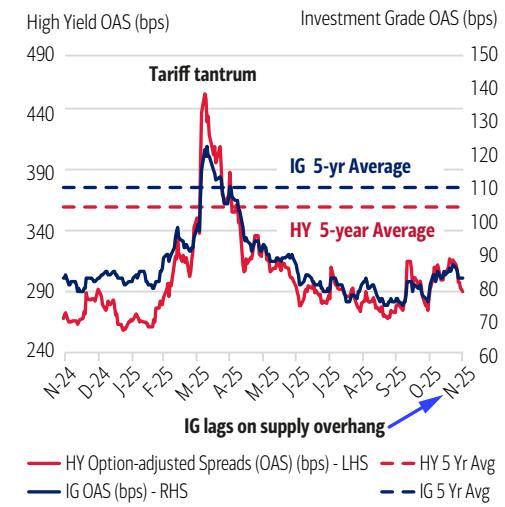
Furthermore, while the rates market expects another two to three Fed rate cuts in 2026, this “average” of expected outcomes belies a wide variety of potential future rate paths. There will be a new Fed chair, and potentially new Federal Open Market Committee (FOMC) governors and Federal Reserve Bank presidents. Any presidential appointees will likely favor lower rates, on balance. Whether this is the correct course or not remains to be seen. There are good reasons to favor lower rates—employment has stalled, consumer sentiment is depressed, and manufacturing (for now) is still in contractionary territory. However, inflation of all measures—personal consumption expenditures and consumer price index, headline and core—remains well above the Fed’s target and is heading in the wrong direction. Furthermore, if new appointees are viewed as being more in tune with administration policies than the overall FOMC prefers, this may embolden Fed hawks to dissent more against rate cuts. If the market meanwhile views rate cuts as overly aggressive, long-end yields could potentially move higher. While our base case remains that rates will be lower overall in 2026, there could be high volatility—which coincidentally also happens to generally be the case for markets during a midterm election year.

Against this backdrop—lower expected rates, tight valuations, high uncertainty—what is the correct path for investors and portfolio managers? Consider being “actively neutral,” in our opinion. Move excess cash into risk assets and Fixed Income of a reasonable duration. Within Fixed Income, remain neutral across sectors and interest-rate risk, being patient until better valuation opportunities afford themselves, thereby making volatility an old friend that you are happy to see rather than an enemy to avoid. For investors more tactically inclined with higher tolerance for price volatility, we do see some select opportunities in longer-dated and longer-duration Fixed Income assets. Long duration is still the “most disliked asset class” within Fixed Income; not coincidentally, this is where some good value remains, in our opinion.

We maintain a neutral view on IG and HY for 2026. Any modest spread widening driven by technicals is expected to be contained by a healthy fundamental backdrop. Credit spreads are ending 2025 near where they began: IG low 80 basis points (bps) and HY mid 200 bps (Exhibit 1). The path, however, was far from linear. Early-year volatility driven by tariffs and macro concerns gave way to exceptionally tight ranges in the second half of the year before modest decompression in Q4 amid leveraged-credit concerns and heavy IG issuance. Despite this, valuations remain historically rich and likely to persist, making carry—not spread tightening—the dominant return driver in 2026.

Macro conditions could argue for a more constructive stance. BofA Global Research projects stronger gross domestic product growth, supporting continued earnings strength—tracking 13% year-over-year for 2025, the second double-digit growth in three years. However, we expect a significant pickup in supply across IG and HY next year, which may pressure spreads to the upside. This would present a technical not a credit issue—and thus should be largely manageable for the market.

Exhibit 1: Credit Spreads Finish the Year Near Starting Levels—Historically Tight Spreads Keep Our 2026 IG and HY Positioning at Neutral.



Source: ICE BofA Investment-grade and High Yield Index; Bloomberg. Data as of November 30, 2025. **Past performance is no guarantee of future results.** Please refer to index definitions at the end of this report. It is not possible to invest directly in an index.

For IG, slower debt growth and robust earnings have improved balance sheets, with upgrades outpacing downgrades for several years. The market appears solid at this stage of the cycle. However, sentiment may be shifting as mergers & acquisitions activity and Artificial Intelligence/data center funding drive expectations for higher gross supply in 2026. Re-leveraging should be led by higher-quality credits, limiting spread pressure. Private Credit and Business Development Companies concerns remain, but exposures are small and unlikely systemic. As IG is yield-driven, lower Treasury yields could pose modest demand headwinds.

HY trends mostly mirror IG. However, HY fundamentals are weaker—downgrades exceed upgrades, and leverage sits near the top of its three-year range—but defaults should remain near recent levels or potentially improve, in our view. Strong earnings and Fed cuts should ease pressure on lower-quality cohorts, and maturity walls have been largely addressed. Elevated supply, including more fallen angels, will be a headwind, with gross issuance expected to nearly double in 2026. Within an HY allocation, we continue to advocate for an up-in-quality/defensive tilt until yields present a more compelling entry point.

The bottom line: We expect 2026 IG and HY spreads to remain largely range-bound. While some modest technical widening is possible, we see no major catalysts for sustained widening. Carry should drive returns, and any significant widening would likely create a buying opportunity. Both IG and HY are positioned to outperform Treasurys in this environment. However, historically low starting spreads—and therefore muted forward excess returns—keep us from moving to a slight overweight.

We maintain a neutral view on Agency MBS. MBS delivered strong total and excess returns in 2025 of 8.1% and 1.5%,¹ supported by both lower rates and spread tightening. Notably, this is the first time in several years that MBS has outperformed IG. Spreads remain near three-year tights; on a relative basis, MBS appears fairly valued versus IG. The recent drop in mortgage rates has improved affordability modestly, but homeowners with existing low-rate mortgages remain reluctant to move. As a result, MBS supply should only rise slightly from current subdued levels—a technical tailwind for the sector.

Looking ahead, 2026's demand backdrop should resemble 2025. The Fed will likely continue reducing MBS holdings, while deposit growth at domestic banks could support modest buying, and foreign demand should remain flat to slightly positive, aided by lower hedging costs amid Fed cuts. This leaves spread-sensitive managers as marginal buyers, suggesting limited room for further spread compression, as their positioning is largely already overweight. That said, carry remains favorable, and the sector can benefit from gradual rate cuts and further declines in volatility. We will monitor housing policy, government-sponsored enterprise reform, and affordability. Although meaningful changes appear unlikely near term, we maintain our neutral stance.

¹ Source: Bloomberg U.S. Mortgage-backed Securities as of December 11, 2025.

Asset Class Proxies and Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Equity Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

U.S. Financials/U.S. Industrials/AA-Credit/BBB-Credit/A-Credit/ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the US domestic market.

U.S. Municipal/Bloomberg Muni Bond Index measures the performance of the Bloomberg U.S. Municipal bond market, which covers the USD- denominated Long-Term tax-exempt bond market with four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

U.S. High Yield/BB-Credit/B-Credit/CCC-Credit/Bloomberg U.S. Corporate High Yield Index: The Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

U.S. Municipal High Yield/Bloomberg High Yield Municipal Index is a benchmark that covers the high yield portion of the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

Emerging Market/Bloomberg Emerging Market USD Index is a flagship hard currency Emerging Markets debt benchmark that includes USD-denominated debt from sovereign, quasi sovereign, and corporate EM issuers.

Cash/U.S. Treasury/Bloomberg U.S. Treasury Index Total Return measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting.

U.S. Mortgage-backed Securities (MBS)/ABS/Bloomberg U.S. Mortgage-backed Securities Index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

U.S. Corporates/Bloomberg U.S. Corporate Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes U.S. dollar-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers. The U.S. Corporate Index is a component of the U.S. Credit and U.S. Aggregate Indices.

Bloomberg Capital Asset-Backed Securities (ABS) Index is composed of debt securities backed by credit card, auto and home equity loans that are rated investment grade or higher by Moody's.

Bloomberg U.S. Commercial Mortgage Backed Securities (CMBS) Index is the Bloomberg Non-Agency Investment Grade CMBS: BBB Total Return Index Unhedged.

Muni High Yield/Bloomberg Muni High Yield Index is a market-value-weighted index that tracks the performance of the U.S. dollar-denominated, tax-exempt, non-investment grade municipal bonds issued by U.S. states, the District of Columbia, U.S. territories, and local governments or agencies.

ICE BofA Investment-grade Index tracks the performance of U.S. dollar-denominated, investment grade (IG), asset-backed securities publicly issued in the U.S. domestic market.

ICE BofA High Yield tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market.

ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade and sub-investment grade corporate debt publicly issued in the U.S. domestic market.

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